STANDARD & POOR'S

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Summary:

San Diego Public Facilities Financing Authority, California; Appropriations; General Obligation

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Credit Profile		
US$156.56 mil lse rev rfdg bnds (San Diego) ser 2007A due 02/15/2032		
Long Term Rating	A-/Positive	New
San Diego Open Space Pk Dist #1, California		
San Diego, California		
SAN DIEGO OPEN SPACE PK DIST #1		
Long Term Rating	A/Positive	Affirmed
San Diego 2003 certs of part (1993 Balboa Park/Mission Bay Pk Rfdg) dtd 06/17/2003 due 11/01/2003-2023		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
San Diego Convtn Ctr Expansion Fing Auth, California		
San Diego, California		
San Diego Convtn Ctr Expansion Fing Auth lse rev bnds ser 1998A dtd 09/01/1998 due 04/01/2002-2018 2028		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
San Diego Mtdb Auth, California		
San Diego, California		
San Diego Mtdb Auth (San Diego) 2003 lse rev rfdg bnds (San Diego Old Twn Lt Rail Transit Extension Rfdg) dtd 05/20/2003 due 06/01/2004-2023		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'A-' long-term rating, and positive outlook, to San Diego Public Facilities Financing Authority, Calif.'s lease revenue refunding ballpark bonds, series 2007A, which were issued in March 2007 as a private placement with Bank of America.

Standard & Poor's also affirmed its 'A' long-term rating, and positive outlook, on the city's general obligation (GO) bonds and affirmed its 'A-' long-term rating, and positive outlook, on the city's existing lease revenue bonds and certificates of participation (COPs).

The 'A-' rating on the ballpark bonds reflects our view of the city's general credit characteristics and its covenant to budget and appropriate annual lease payments for the baseball stadium, which was completed in 2004. Under a site lease, the city leases the city-owned portion of the baseball stadium, which represents the site and 70% of the ballpark that was completed in 2004, to the San Diego Public Facilities Financing Authority. The authority, in turn, subleases the property to the city.

San Diego might abate lease payments only if the use of the facility is interrupted due to damage, destruction, title defect, or condemnation. To mitigate the risk of abatement in such cases, the lease agreement requires rental interruption insurance of at least 24 months. In addition, the lease requires a debt service reserve fund equal to the least of maximum annual lease payments, 125% of average annual lease payments, or 10% of the principal amount on the bonds; the reserve is currently 66% funded with a surety policy by Ambac Assurance Corp. (A/Negative/--). The lease is a triple-net lease and the city, as lessee, is responsible for all taxes, maintenance, and insurance on the facility. The lease agreement does not provide a security interest in the facility and the lessor does not have the option to re-lease or sell the property in the event of default. Ownership of the entire baseball stadium reverts to the city upon termination of a Joint Use and Management Agreement between the city and the Padres L.P. Although the owner of the Padres has indicated his intent to sell the team, any new franchise owner must agree to assume the Padres' obligations under the agreement, according to a 1998 Memorandum of Understanding agreement between the city and the team.

Although San Diego's covenant to budget and appropriate for lease payments legally secures debt service, the city practically supports annual debt service of about $11 million with transient occupancy taxes (TOT). The city also has an internal policy to maintain a rate stabilization reserve equal to half of annual debt service for debt that is practically supported by TOT allocations to offset potential fluctuations in this revenue stream. As fiscal year-end 2007, the rate stabilization reserve balance for all lease revenue bonds and COPs practically supported with TOT revenues totaled $19.7 million.

The ratings also reflect our view of the city's general credit characteristics, which include:

- A diversified economy that has exhibited growth in assessed valuation (AV) in the past several years, although property tax growth is beginning to slow;
- Strong income and wealth indicators;
- Good reserve levels and recent improvements in management practices; and
- A moderate overall net debt burden.

These strengths are mitigated in our opinion by San Diego's:

- Recent economic declines, which we believe are likely to continue to negatively affect future sales and transit occupancy tax collections;
- Continued identified weaknesses in internal financial controls;
- Limited revenue-raising flexibility and projected budgetary gaps in the next five years, which could require further cuts or revenue enhancements; and
- Additional deferred maintenance needs and pension and other postemployment benefits (OPEB) liabilities, which we believe could pressure the city's general fund operations--although we believe the overall debt burden, including pension and retiree benefit liabilities, remains moderate as a percentage of the city's tax base.

San Diego's population, at about 1.3 million in 2007, has grown an average of about 1% per year since the 2000 U.S. Census. The economy consists of a mix of various high-tech clusters, including biotech and telecommunications, combined with a reliance on tourism and the military and defense industries. The city's economic base is also anchored by higher education and major scientific research institutions, including the University of California, San Diego, San Diego State University, Scripps Research Institute, the Salk Institute for Biological Studies, and the San Diego Supercomputer Center. On a per capita basis, market values are extremely strong, in our opinion, at approximately $134,000. Median household effective buying income is also what we consider strong, at 111% of the national average in 2007. City unemployment in October 2008, based on preliminary data from the Bureau of Labor Statistics, rose to 6.5% from 5% earlier in the year, which is on par with the national unemployment level.

The city's AV rose an additional 5.7% in fiscal 2009 to $189.2 billion. Although AV growth has continued, delinquent property tax payments and lower supplemental property taxes have slowed San Diego's property tax revenue growth. Secured property tax collection rates have declined to 96% in fiscal 2008 from 99% in fiscal 2004; furthermore, the city does not participate in the San Diego County's Teeter Plan, which remits 100% property tax collection rates for participating underlying municipalities. We believe a significant weakening in the San Diego metropolitan area housing market is reflected in a 49% decline in the city's residential permit valuations between fiscals 2005 and 2008. According to the S&P/Case-Schiller Index, housing prices in the San Diego area fell by what we view has a large 26% between September 2007 and September 2008. The region has seen a 158% increase in foreclosure activity in 2008 through October compared with the previous year with 1.52% of the county's housing units in some stage of foreclosure. Slowing trends in tourism, a major driver for the city's economy, are reflected in hotel occupancy rates, which fell to an estimated 71% in 2008 from 73% in 2007 and are forecast to fall another 2.3% in 2009.

San Diego's major sources of general fund revenue in fiscal 2008, based on unaudited results, included property taxes (about 35% of general fund revenue); sales taxes (22%); transfers from other funds (13%); and transient occupancy taxes (8%). The city does not levy a utility user tax or a trash collection fee. The city spends the majority of its budget on public safety and homeland security, which represented 52% of general fund expenditures in fiscal 2008. In fiscal 2007, San Diego's unreserved general fund balance totaled approximately $96 million, or what we view as a strong 10% of expenditures and transfers. In fiscal 2008, unaudited results reflect a $22 million drawdown, after transfers, to bring the unreserved general fund balance to about $74 million, or a good 6.6% of expenditures, in our opinion. The drawdown is attributed to reduced construction and retail sales activity from the housing market decline in late fiscal 2008 and higher-than-anticipated costs due to unforeseen events, including large wildfires and a landslide in the city.

Due, in part, to Proposition 218, which limits the ability of city government in California to raise taxes without voter approval, and the city charter, which prohibits garbage fees levied on single-family owners, San Diego has limited revenue-raising flexibility. In the current fiscal year, declines in sales taxes and transient occupancy taxes contributed to an estimated $31 million budget shortfall, or 2.7% of general fund revenues, as of Oct. 15, 2008. In November 2008, the mayor proposed measures to restore structural budgetary balance including departmental savings, slowing police officer recruitment, and reducing positions in public works and other departments. The city council has since adopted the majority of the proposed budget adjustments and authorized transfers of $5.5 million from other funds into the general fund to address the fiscal 2009 budget deficit identified to date.

Although San Diego has not experienced any investment losses in its portfolio, the city believes recent weakness in investment earnings will likely increase its future annual required contribution rates (ARC) to the pension system. On Nov. 30, 2008, the market value of the pension system's assets was 15% below the market value on June 30, 2008. Although the fiscal 2011 ARC won't be determined until the June 30, 2009, actuarial valuation, assuming a 20% market value decline in assets, city officials estimate future combined annual required OPEB and pension contributions could increase to represent about 14%-23% of general fund revenues by fiscal 2014. The city's five-year fiscal outlook conservatively projects budget gaps of $44 million and $68 million in fiscal 2010 and 2011, respectively, assuming higher pension fund contribution rates, flat revenue trends, and continued funding of the city's priority areas, including: a targeted 8% general fund reserve by 2012, pension and OPEB annual required contributions, deferred maintenance needs, Americans with Disabilities Act and stormwater runoff compliance, and building reserve levels to cover 50% of worker's compensation and public liability claims. The forecast, however, does not assume potential further deterioration in state funding levels due to the state's budget condition nor does it include additional salary and wage increases.

We consider San Diego's management practices "good" under Standard & Poor's Financial Management Assessment (FMA) methodology. An FMA of good indicates practices exist in most areas, although not all may be formalized or regularly monitored by government officials.

Overall net debt is what we consider moderate, at $4,752 per capita and 3.8% of market value. Including the city's pension and OPEB liabilities, total overall net debt is still moderate, in our view at 5.1% of market value, and what we consider to be a high $6,458 per capita. Officials estimate that general fund deferred maintenance capital needs total up to $900 million, which they expect to fund with a combination of debt and cash from Proposition 1B funding that San Diego receives from the state for street projects. Total fiscal 2007 annual debt service across all governmental funds represents what we view as a moderate 10.4% of governmental expenditures. Combined debt service and pay-as-you-go contributions for pension and retiree health benefits represent an elevated 19% of fiscal 2007 governmental expenditures, in our opinion. We view amortization of existing debt, excluding utility revenue debt, as slightly below average, with about 46% of principal to be retired within 10 years and 90% within 20 years. The city has no variable-rate debt outstanding at present.

Outlook

The positive outlook reflects our view of the city's ongoing enhancements to financial management practices and financial controls, as well as its apparent commitment to addressing all of its liabilities including funding its retirement benefit liabilities in an actuarially sound way. The outlook remains positive despite a challenging economic context, which is contributing to a difficult revenue environment. In addition, California's continuing budgetary stress raises the specter of unknown changes that could have detrimental implications for the city's total revenue base. Even if the state does not change the timing or allocation of revenues, San Diego continues to have very limited revenue-raising flexibility. These challenges notwithstanding, we could raise the rating if the city restores a practice of timely financial reporting, maintains good financial reserves and a structurally balanced budget, and resolves weaknesses in its financial controls.

Pension And OPEB

As of June 30, 2008, the San Diego City Employees' Retirement System pension system was 78.2% funded and the unfunded actuarial accrued liability totaled $1.3 billion with an assumed 7.75% rate of return. Under these assumptions, the total ARC in fiscal 2010 is $154 million; however, city officials expect the decline in asset market value since June 2008 to increase the ARC in future years. An actuarial analysis for the city's postretirement medical benefits program reflects a $1.03 billion total liability as of June 30, 2008, assuming a 6.7% assumed weighted discount rate and 30-year amortization. The estimated OPEB ARC for the general fund in fiscal 2010 is $74 million. In fiscal 2008, San Diego paid $23 million toward pay-as-you-go OPEB costs and contributed another $30 million to establish an irrevocable trust fund toward prefunding its OPEB liability per an agreement with the California Public Employees' Retirement System; the city deposited another $24 million in fiscal 2009, which increased the trust fund's current balance to $54 million. The city council also recently amended the retiree benefit plan for employees hired after July 1, 2009, in an attempt to reduce the future liability for retiree benefits.

Audits And Internal Controls

Since February 2004, when the Securities and Exchange Commission began investigations of the city related to disclosure practices and funding of the city's pension system, San Diego has released audited financial statements for fiscals 2003 through 2007 and has made progress toward formalizing new financial management policies, transforming its administrative structure and improving its internal controls. (For further information, see San Diego's GO and appropriation rating rationale published May 15, 2008, on RatingsDirect.) Although the city acknowledges that it has additional improvements to make on its internal controls, it has established new governmental positions and committees designed to coordinate the flow of information within the city and accurate disclosure to the markets. San Diego recently released its audited fiscal 2007 comprehensive annual financial report and city officials expect the release of the fiscal 2008 audit by March 2009. City management expects to launch new enterprise resource planning software in the second half of fiscal 2009 to help resolve internal control weaknesses and aid in the timely release of future financial reports.

Ratings Detail (As Of December 19, 2008)		
San Diego		
Long Term Rating	A/Positive	Affirmed
San Diego caps imps prog certs of part (Balboa Pk & Mission Bay Pk) ser 1996A & rfdg ser 2003		
Long Term Rating	A-/Positive	Affirmed
San Diego rfdg certs of part (Balboa Pk & Mission Bay Pk Cap) ser 1996B		
Long Term Rating	A-/Positive	Affirmed
San Diego Mtdb Auth, California		
San Diego, California		
San Diego Mtdb Auth (San Diego) lse rfdg ser 94		
Long Term Rating	A-/Positive	Affirmed
San Diego Mtdb Auth (San Diego) (Bayside Lt Rail Trans Ext Proj) lse rev ser 89		
Long Term Rating	A-/Positive	Affirmed
San Diego Pub Facs Fincg Auth, California		
San Diego, California		
San Diego Pub Fac Fing Auth lse rev bnds (Fire & Life Safety Fac Proj) ser 2002B dtd 06/15/2002 due 04/01/2004-2024 2027 2032		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.

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